



The  
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# An uncertain giant

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# An uncertain giant

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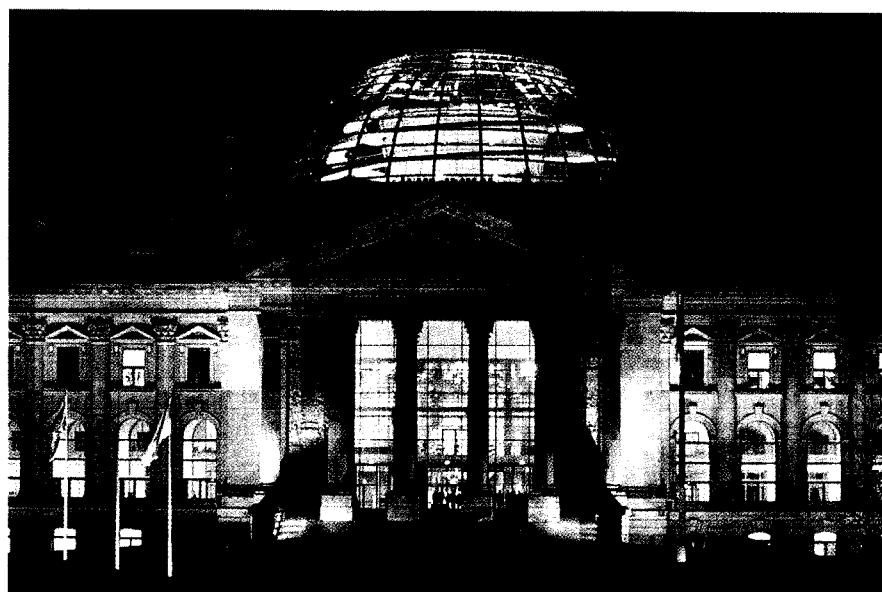
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Germany is plagued by a severe economic malaise and by uncertainty about its place in the world, says Xan Smiley

AT THE heart of Germany's old-new capital, Berlin, a heady mixture of symbols confronts the visitor. Start with the Reichstag, restored as the unified nation's parliament: a ponderous Prussian hulk of a building with an awkward history, renovated and now capped with a delicate glass dome, proclaims a peculiar yet suitably mixed message of old solidity and adventurous novelty.

Then look across to the Brandenburg Gate, a mocking reminder of Germany's division that until 1989 stood gloomily alone in the border wasteland near the site of Hitler's old bunker. Now that it has been restored, the horse-drawn chariot on top of the majestic gate seems poised to take off eastwards into territories soon again to fall within Germany's economic embrace.

And the bunker itself, a place that most Germans would rather expunge from their capital, if not from their historical memory? The country's leaders have courageously decided to erect, close to the site of the bunker, a massive and eerie memorial to a crime that must not be forgotten, however normal Germany has now become and however blameless today's Germans are for the appalling crimes committed by their grandparents.

On the face of things, Germany has finally come out of its post-war shell. Twelve years ago it emerged united, suddenly much more populous and with a far bigger economy than its chief counterparts in Europe—although, by taking in the

poor east, it became less wealthy per head. It now has 82m people, against about 60m each for France and Britain, which makes it the undisputed giant at the heart of one of the two richest continents in the world. The European Union has 370m people against America's 270m, and a combined annual GDP of \$7.9 trillion against America's \$10.1 trillion. In little more than a year's time, if the 15-country EU expands as expected to take in another ten countries, mainly in Central Europe, the Union's population will rise to 460m. Hence the symbolism, once again, of moving Germany's capital in 1999 from the sleepy little Rhineland town of Bonn, a mere 55km (34 miles) from the border with Belgium, to raucous, once-imperial Berlin, just 80km from the frontier with Poland.

### Look east

The shift in Germany's centre of gravity to the east has been accompanied by the departure of French, British and Russian troops from German soil, and by the reduction of once-mighty Russia to the economic weight of the Netherlands. Moreover, the burgeoning European club of which Germany is the biggest member will soon embrace Poland and three Baltic countries that not so long ago seemed an integral part of Russia's empire.

Yet just as Germany seems to be retaking its place at the head of Europe's top table of nations, there is growing concern (in Germany as well as abroad) about a "Ger- ➤

#### Sources

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man malaise"—mainly of an economic kind, but also reflecting uncertainty over how the country might play its part on the European and global stage. The chancellor, Gerhard Schröder, recently won an extremely narrow election victory, which he owes partly to his decision to thumb his nose at the government of the United States, a country whose friendship has been the cornerstone of German foreign policy for half a century. Germany's equally important post-war friendship with France has also fallen into disrepair, although efforts have recently been made to restore it. A third friendship, with Britain, seemed to be taking root two years ago, but never quite flowered.

In sum, for the first time since the second world war, Germany has given the impression of wanting to carve out a more independent place in world affairs for itself—but it does not yet seem to have worked out what to do with it.

Germany's economy remains easily the biggest in Europe, larger by a third than Britain's or France's. But the mighty American economy is now five times as big as the German one, against 3.7 times in 1990, and the gap is widening. For the past eight years, the German economy has been the slowest-growing in the whole of the European Union, so in comparison with its peers it has lost ground (see chart 1). Recently, Germany has suffered the indignity of being formally reprimanded by the EU for letting its deficit get too big.

True, in 1990 it was landed with the colossal financial burden—however welcome politically—of absorbing a bankrupt country, the former communist-run German Democratic Republic. True, Germany's is an export-driven economy gasping for breath during a world economic slump. But it is also stifled by a hugely restrictive and intrusive web of regulations, and weighed down by one of the most expensive, inflexible and protected labour forces in the world.

### Fading lustre

Many of Germany's greatest firms and institutions are in trouble. All of its four biggest banks—Deutsche Bank, HypoVereinsbank, Commerzbank and Dresdner Bank—require drastic and urgent restructuring. When in 1999 Germany committed itself to surrendering its beloved D-mark, the symbol of post-war stability, in favour of a new European currency that now embraces 12 out of the EU's 15 members, there was much talk about Frankfurt ousting the City of London as Europe's financial hub

(Britain having stayed out of the project). But in the past few years the DAX index of Germany's top companies has slumped even further than the stockmarkets in New York, London and Paris, and Frankfurt's much-vaunted *Neuer Markt* for high-tech shares, having lost 90% of its value in the past two years, is closing as a separate market early next year. In the past couple of years, Germany has been shocked by formerly rock-solid companies going bust.

Germany's once well-regarded education system, too, has lost its lustre. When the OECD last year published the results of its Programme of International Student Assessment (PISA) on the attainments of 15-year-olds in 30 rich countries, Germany came an embarrassing 21st, suggesting, among other things, that the famously high quality of Germany's shop-floor workers may soon start to fall.

Even standards of public morality and civic virtue seem to be declining. A few years ago a party slush-fund scandal tarnished the name of Helmut Kohl after 25 years at the head of the Christian Democrat party, 16 of them as Germany's chancellor. In the past couple of years a rash of scandals involving all the main parties has erupted. And note that Transparency International, a Berlin-based body that rates countries according to the cleanliness of their public ethics, puts Germany in 18th place in its latest league table, one rung below Chile.

Most German politicians these days intone in unison that "we need reform", but few seem to recognise how urgent and radical it has to be if their economy is to regain its old fizz. Before the election in September, neither of the two main parties—Mr Schröder's centre-left Social Democrats and Edmund Stoiber's conservative com-

bination of Christian Democrats and their Bavarian sister party, the Christian Social Union—dared promote any ideas that might rattle the country's comfortable consensus. In the eyes of Anglo-Saxon-minded free-marketeers, the Germans are simply in denial, their government "sleepwalking into stagnation".

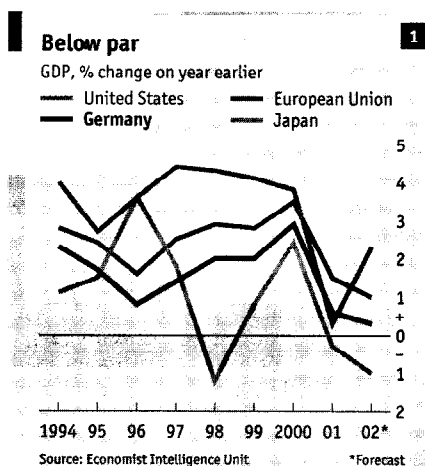
### But why worry?

Many Germans, on the centre-right as well as the centre-left, think their *laissez-faire* critics are exaggerating. Carpers have been saying much the same thing for decades, yet Germany remains a rich and comfortable country that treats its old, its sick and its unemployed far more generously than does, say, America or Britain. "Germans live very well. We have a fantastic welfare system," said Alfred Tacke, a confidant of Mr Schröder in the economics ministry. "Our infrastructure is fantastic. Our workers have six or even eight weeks' holiday a year." The Americans, he says, work about 25% more hours in a year. So what, he seems to be implying, if Germany drops a few places in those league tables of growth and productivity?

He has a point. For quality of life and protection of the weak, his country remains at the top of the league. Its welfare system is enviably generous. Its environmental and health standards are high. Its sense of civic virtue, despite that rash of corruption scandals, remains pretty solid. Public discourse is vigorous but dignified. Germany is an eminently civilised country with a solidly entrenched democracy. It threatens nobody. The ghosts of Hitler have been laid as well as they can be. If compromise and consensus slow down growth but deliver civil serenity, then let us—say many Germans—pay the price.

But the price could well rise. Some demographic projections suggest that, without net immigration on a grand scale, Germany's population could shrink from 82m today to about 60m, the same as France's and Britain's, within 30 years. That would make public pensions and health care at their present level unaffordable.

In his first term of office, Mr Schröder started some reforms, albeit tentatively, in several important areas: taxation, labour-market law and pensions. But as election day approached, they slowed to a halt. As Mr Tacke observed, "Reformist programmes don't win elections." Now that the chancellor is back in the saddle for the next four years, will he become more reform-minded again? The first place to look for an answer is German politics. ■



# The perils of pragmatism

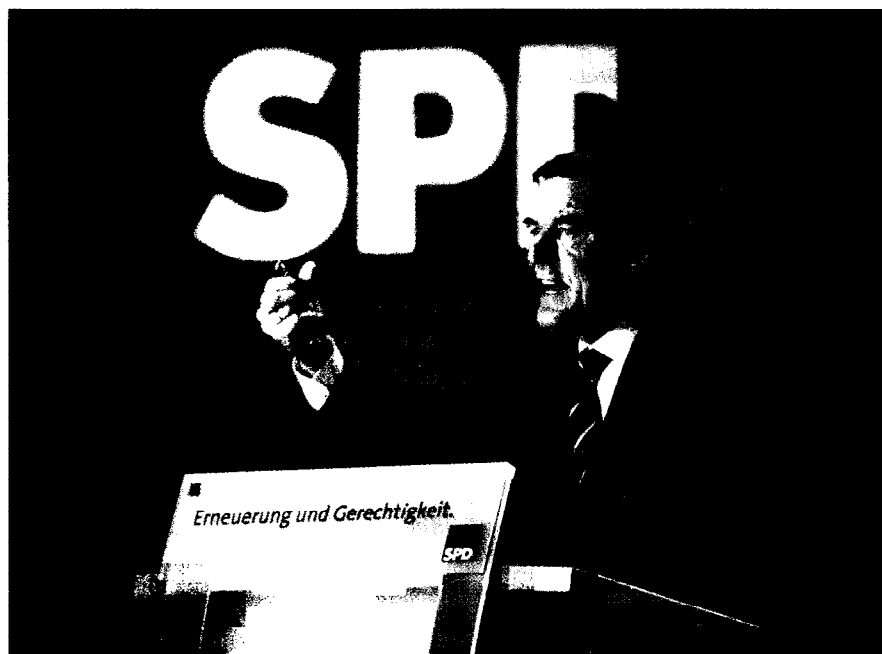
Gerhard Schröder is a brilliant tactician. But where's the strategy?

SINCE his narrow election victory, Mr Schröder has sorely disappointed his party's would-be modernisers and the dwindling number of businesspeople who think he can turn Germany's fortunes round. A hopeful early sign was his appointment of Wolfgang Clement, until then premier of North Rhine-Westphalia, Germany's biggest *Land* (state), to run a beefy "super-ministry" for economics and labour. But his new team as a whole looks no keener to ram through radical reforms than the previous one.

Mr Schröder's dismal post-election performance and apparent lack of stomach for forging boldly ahead have cast reformers into gloom. Many Germans who voted for him feel betrayed. Astonishingly, within two months of his victory, pollsters were already putting his Social Democrats 14 percentage points behind the Christian Democrats and their Bavarian allies.

In retrospect, the chancellor must consider himself extremely lucky to have held on to his job at all. In mid-summer, his chances seemed to be ebbing away. He had patently failed to keep the biggest promise he made to the German people in his first term of office—that he would bring unemployment down from 4m (around 9% of the workforce) to below 3.5m. It did come down at first, but for the past year it has been hovering around 4m again. Last spring Mr Schröder's Social Democrats were running up to ten points behind the opposition, led by Edmund Stoiber, the worthy, socially conservative premier of prosperous Bavaria.

The chancellor was saved by a string of what turned out to be lucky breaks, and squeaked home by polling just 6,000 votes more, in an electorate of 61.4m, than the conservative combination of Christian Democrats and their Bavarian sister party, Mr Stoiber's Christian Social Union. The first break came with the terrible floods of August, when the Elbe river and its tributaries ravaged Saxony's heartland and other parts of the east. Mr Schröder seized the moment, using his fabled charm to persuade the beleaguered easterners that he was their friend. He offered cash, comfort and a spirit of national solidarity. Mr Stoiber remained near-invisible.



Is Schröder losing his grip already?

Mr Schröder's second break was the growing threat of war in the Middle East and the apparent readiness of President George Bush to fight Iraq. Today's Germans are reluctant warriors, and the chancellor sensed that the mood was against the Americans. He may have genuinely believed, along with some other European leaders, that America's approach was wrong, even if it got a United Nations mandate, but to insult his country's most generous and steadfast post-war ally was patently self-serving.

The third break was inadvertently provided by the Free Democrats (FDP), Germany's liberals, who might have made a coalition partner for either big party but seemed more likely to team up with the right. Earlier in the year, pollsters said they might pick up as much as 12-13% of the vote, a lot more than the Greens, Mr Schröder's often awkward partners in the ruling coalition. But Jürgen Möllemann, then a deputy chairman of the party and its boss in North Rhine-Westphalia, got embroiled in a row over his outspoken pro-Palestinian views and alleged anti-

Semitism. This made many Germans queasy. Suddenly the prospect of the liberals taking the foreign ministry, as they had done in several earlier coalitions, seemed fraught with risk. Liberal support slipped.

At the same time, the Greens benefited from the popularity of their unofficial leader and Germany's incumbent foreign minister, Joschka Fischer, as well as from fears of war and ecological worries stirred up by the floods. On election day, they gained 8.6% of the vote against the liberals' 7.4%. With the two main parties finishing neck and neck, with 38.5% of the national vote each, that margin was just enough to ensure that the Greens would be a stronger partner for the centre-left than the liberals would be for the centre-right.

Moreover, the defects of Mr Stoiber, the conservative challenger, became plainer as the campaign wore on. The then 60-year-old Bavarian Catholic, with his rasping, schoolmasterish speech, came over as stiff and old-fashioned. He lacked his 58-year-old rival's easy rapport, relaxed manner and deep-throated eloquence. Despite his model family life, he got far fewer ►►



women's votes than the four-times-married chancellor. And in eastern Germany, Mr Schröder cleaned up.

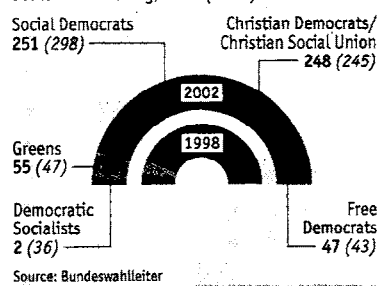
That Mr Schröder is a masterly campaigner and a shrewd tactician is not in doubt. He can also be courageous, as he was when he sent German troops to Kosovo in 1999 and to Afghanistan last year. And he notched up some creditable achievements during his first four years in office. He introduced bold and sensible tax reforms, encouraged people to start making private pension provision, and gave immigrants a better deal by making it easier for them to get German nationality. Indeed, by mid-term, Mr Schröder had begun to look good. The economy started to pep up and unemployment dropped.

### Steady as she goes

But about 18 months ago Mr Schröder stopped being bold and started to reinvent himself as a helmsman with a steady hand on the tiller. He gave new perks to the trade unions. When Germany's economy began to dip again, he seemed at a loss; then, last spring, he asked Peter Hartz, an old friend from his days on Volkswagen's supervisory board, quickly to draw up a report on improving the labour market. In

### In by a whisker

Seats in Bundestag, 2002 (1998)



July Mr Hartz suggested a number of sensible ways to get more people into work, which Mr Schröder promptly embraced.

The trouble with Mr Schröder is that he is a pragmatist, not a radical reformer. He enjoys power, but he also likes to be liked. His earlier reputation as a moderniser rested largely with his closeness to big business, particularly VW, when he was premier of the state of Lower Saxony. But he is also a creature of the cosy corporatist consensus that served his country so well in the early decades after the second world war. "We Germans do not believe in big bangs," says one of his closest advisers. In

particular, Mr Schröder does not believe in fighting against Germany's still-powerful trade unions, who are understandably reluctant to loosen up the labour laws.

To be fair to him, if the conservatives had been returned to power, they would probably not be doing much better. After all, it was conservative governments, as much as centre-left ones, that have been responsible over the years for Germany's high taxes and the steady rise in its labour and social-security costs. Mr Stoiber himself has a record of intervention and deal-making with companies and trade unions in Bavaria. Germany's only truly free-market party are the liberals, who in a coalition with the conservatives might have made a difference, but probably not much.

But then Germans as a whole do not really believe that a crisis is afoot. Indeed, that was the message they conveyed by voting as they did in September. "We are not like Britain in 1979," is a regular refrain, usually followed by the assertion that the measures applied by Britain's then prime minister, Margaret Thatcher, would not be suitable for their own country anyway. In Germany, compromise and consensus remain the order of the day. But can they still deliver the goods? ■

## Is Deutschland AG kaputt?

### What's ailing German industry

CAN this really be the country of the *Wirtschaftswunder*—the economic miracle that brought burgeoning growth to Germany from the end of the second world war to the mid-1980s? Since the post-unification boomlet ended in 1994, growth has averaged only 1.6% a year, the lowest rate in the European Union; this year, says Wolfgang Clement, the new economics minister, the figure may be only 0.5%; some government advisers predict even less. Foreign direct investment into Germany has been paltry, and virtually all of Germany's biggest firms are setting up plants abroad to make products more cheaply. Bankruptcies this year are a third up even on last year's record.

The hourly cost of labour in manufacturing industry in western Germany, including wages, social-security (including health) and pension contributions, is 13% more than in America, 43% more than in Britain and 59% more than in Spain, ac-

cording to the US Bureau of Labour Statistics (see chart 3). Yet Germany's once-admired productivity no longer outstrips its main rivals'. And although Germany has increased its exports (and is still the

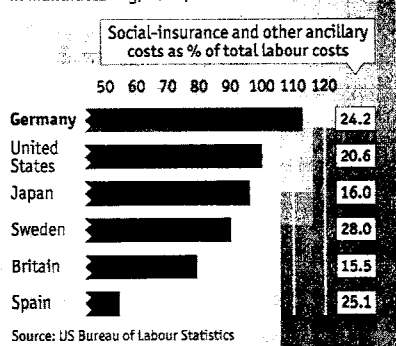
world's second-biggest exporter), those of other countries have grown faster. Its global share has dipped from 11.8% in 1992 to an estimated 9.7% in 2002.

When Germany agreed to swap its cherished D-mark for the euro, it hoped that the move would do its financial markets a power of good. It didn't. Indeed, the country's banking system is now in crisis. In the past few months, Deutsche Bank and Dresdner Bank have announced layoffs, of 14,500 and 11,000 people respectively. HypoVereinsbank, Germany's second-biggest bank, has watched its profits dwindle and expects to make loan-loss provisions of €3.3 billion for this year. Rumours of a liquidity problem have swirled around Commerzbank.

A merger between Deutsche and Dresdner failed miserably two years ago, and the marriage of Dresdner to Allianz, a Munich-based insurer, has been a flop. Plans two years ago for Deutsche Börse, ▶

### Heavy going

Hourly labour costs for production workers in manufacturing, 2001, US=100



► which runs Frankfurt's stockmarket, to take over the London Stock Exchange ended in a mess, and Frankfurt's *Neuer Markt* for high-tech shares is to close soon after less than six years in business. Talk of Frankfurt taking over from the City of London as the hub of European finance has evaporated. Investment banking, in particular, has floundered as its big banks have failed to consolidate or expand. "We completely missed the boat," says a leading Frankfurt investment banker.

The Germans have been dismayed suddenly to find their firms vulnerable to hostile foreign raiders. The takeover two years ago of Mannesmann, an engineering-cum-mobile-phone giant, by a British firm, Vodafone AirTouch (as it was then called), was a heavy psychological blow to German corporate pride. Mr Schröder at first tried to resist the takeover but eventually accepted the inevitable. "Goodbye, Germany AG," said Rolf Breuer, then head of Deutsche Bank.

#### **Bestridding the world or doing the splits?**

Two years ago, a German business journalist, Werner Meyer-Larsen, wrote a book called "Germany Inc: The New German Juggernaut and its Challenge to World Business". A new era, he wrote, had started in 1998 when Daimler-Benz bought America's Chrysler, and he cited a number of other examples of German firms "thinking big" and "going west".

Deutsche Bank bought New York's Bankers Trust. Bertelsmann, a German publisher, bought Random House, the biggest American book-producer. Holtzbrinck, the owner of some weighty newspapers, bought three leading American publishers. Hoechst, a Frankfurt chemicals company, teamed up with a big American rival, Marion Merrill Dow, before merging with its biggest French one, Rhône-Poulenc, to become Aventis. Munich-based Allianz, Europe's biggest insurance company, had already bought America's Fireman's Fund. And Europe's Airbus, in which DaimlerChrysler's subsidiary, DASA, is a partner, had become Boeing's biggest competitor.

But Mr Meyer-Larsen may have got a little carried away. For sure, the DaimlerChrysler deal marked a striking international advance for German business. Daimler-Benz's boss, Jürgen Schrempp, the nearest thing to a business hero in Germany, seemed to be working wonders. But the business climate has got tougher, and a few years on several of those other link-ups look less triumphant.



**VW's strength is its flexibility**

In any event, many of Germany's firms remain small by international standards. Of the world's biggest 500 companies in market capitalisation, 238 are American, 50 Japanese, 36 British, 29 French and only 21 German.

One reason why Germany's biggest firms, such as VW, stand up to world competition is that they invariably have special deals to keep their workforces flexible. For example, the number of hours worked at Wolfsburg, VW's biggest plant, which employs over 50,000 workers, varies hugely according to the state of the market. At VW and elsewhere, millions of workers, in return for a shorter average working week, have been moving to new systems of "task fulfilment" rather than having to work a certain number of hours.

#### **Mittelstand mutterings**

The country's *Mittelstand* of small and medium-sized firms enjoys less flexibility. Many of these firms would love wage bargaining to be done at company level, not—as is usual—in nationwide bargaining with one of the giant trade unions. But most of the leeway, they feel, is on the other side. For instance, it is easy for workers to report sick, and they often do. The director of one chamber of commerce notes wryly that illness strikes selectively: 70% of the time, he says, on a Monday or a Friday. When workers are sick, they get full pay for six weeks. *Mittelstand* managers suggest that sick pay should start at 80% of the full wage, and drop with a prolonged absence.

Another source of irritation is the right of any employee to move from full- to part-time employment, whether it suits the employer or not. This discourages firms from hiring young women who might suddenly demand time off to look after a baby. Such

provisions hit smaller companies much harder than big ones.

Yet another *Mittelstand* gripe is that Germany's high income-tax rates hurt the *Mittelstand* more than bigger firms because, being almost all family- or trust-owned, they tend to distribute profits in the form of higher pay. Mr Schröder's cut in corporation tax was more generous than that in income tax—yet another reason why many *Mittelstanders* complain that the chancellor is friendly to big business but instinctively hostile to smaller capitalists like themselves.

Another big *Mittelstand* headache is raising credit. The big banks, they say, are unhelpful. The banks deny this, but the sort of *Mittelstand* companies they deal with tend to be at the top end of the scale. A score of companies that arguably qualify for the *Mittelstand* category (because they are unlisted, and owned by families or foundations) have a turnover that exceeds €1 billion. These substantial *Mittelstand* companies include such famous names as Miele (white goods), Behr (air conditioners), Stihl (chainsaws) and Trumpf (laser-cutters), which each have a turnover of between €1 billion and €2 billion and employ between 5,000 and 15,000 people. It is further down the ladder that Germany's banking system is proving inadequate to satisfy the *Mittelstand's* thirst for credit.

Germans who prefer to be self-employed so that they can avoid paying salaried workers' full social-security contributions also complain that the dice are loaded against them. For example, lorry drivers who work on contract for a single company have been told that under new rules they count as part of the firm for which they deliver, adding 41% to the cost ►►

of employing them. As a result, a lot of freelance Polish truckers are now distributing goods at a cheaper rate, taking jobs from their German counterparts. In a similar vein, the director of Hanover's chamber of industry and commerce, Wilfried Prewo, points out how much harder it is to become a taxi-driver in Germany than, say, in the United States. "Our logic is that you must always, if possible, be an employee," he sighs.

Berthold Leibinger, the doyen of Trumpf, a classic *Mittelstand* firm based in Stuttgart, is another critic of restrictions that hamper entrepreneurship. "The Social Democrats don't understand the role and importance of the *Mittelstand*," he says. "They're not pragmatic." They're particularly hostile, he says, to people who inherited their firms. "We've become a safety-crazy nation," he says. "We need to be more risk-minded. It's unbelievable that in two generations we've moved from a country that wanted to cover the world [in business] to one that is afraid of itself."

According to an old joke among *Mittel-*

standers, Bill Gates could not have made his fortune in Germany because it is illegal to turn a garage without a window into an office. Ah well, the jest goes on, Mr Gates would at least have ended up as a senior manager in a big corporation. But no: large German companies rarely give good jobs to university drop-outs.

### Old-fashioned virtues

With so much to complain about, how do so many German firms still manage to do so well? The answer lies in good old-fashioned hard work, efficiency, attention to detail and precision, pride and high standards, particularly in engineering. In that respect, another part of the corporate tradition of German business, the apprentice system, still works well: newcomers join firms at token pay, usually for three-and-a-half years, and spend a day or more a week undergoing formal training elsewhere at the expense of the state—and then, if the firm likes them, join as full-fledged and often very loyal staff members.

Many leading businessmen—including

Josef Ackermann, the (Swiss) new Deutsche Bank boss, Paul Achleitner, Allianz's (Austrian) chief financial officer, and Gerhard Cromme, head of ThyssenKrupp's supervisory board—are known to be frustrated by the German economy's over-regulation. Their calls for a less restrictive regime may gradually be heard. Many of the new wave of Germany's top businessmen have had experience in the United States, and feel that degrees in business management (such as those now offered by the Stuttgart Institute of Management and Technology, and by the European School of Management and Technology founded in Berlin in October) should be much more widely available in Germany.

"For the past ten years we haven't been moving," says Hans-Olaf Henkel, a former head of IBM in Germany and for a time a notably outspoken head of the Federation of German Industry (BDI). Like other go-ahead businessmen, he recites a litany of measures that would help to free the economy but concludes gloomily: "The political will just isn't there." ■

## Loosen up or lose out

Germany has far too many rules and regulations

**M**OST analysts readily agree on what is wrong with the German economy. First and foremost, the labour market is far too sticky. Second, taxes and social-security contributions are too high and profits too low. Third, and not unconnected, social-security payments, pensions and health-care arrangements are too generous. And fourth, there is far too much red tape. Frustrated businessmen often say that in English-speaking countries everything is allowed unless specifically forbidden; in Germany, it is the other way round.

Mr Schröder made a useful start on tax reform in his first term by cutting corporate taxes from 52% to 39%. He also initiated a step-by-step reduction in income-tax rates, starting in 1998. The top rate was due to fall from 53% to 42% by 2005, though he decided just before the election to delay the latest scheduled cuts by a year, to help pay for flood damage. One of his more far-sighted reforms—which, to their shame, was opposed by the conservatives—was the abolition of capital-gains taxes on firms selling their cross-holdings in other companies; this, it was hoped, en-

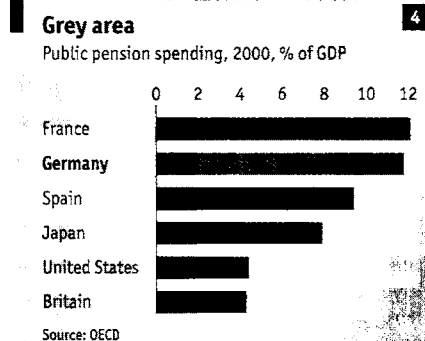
courage Germany's corporate giants (which tend to own chunks of each other) to unbundle themselves. But then markets started to plummet, so the sell-off has been slower than expected.

One of the biggest strains on the welfare system is public pensions. On average, Germans retire at just over 60, earlier than people in most other rich countries, despite an official retirement age of 65. Pensions already swallow 12% of GDP. Compulsory pension contributions, paid

half-and-half by employees and employers, have just been raised from 19.1% to 19.5% of gross wages.

But things are set to get a lot worse because the country is greying fast. Whereas currently there are two people of working age for every pensioner, on present trends there will be only one by 2035. Mr Schröder's government last year enacted a bill that encourages people to take out private pensions, helped by a government subsidy. Starting this year, they can put 1% of their pay into a private account, rising to 4% in 2008; but so far the take-up has been slow. That may be because, by most countries' standards, state pensions remain extremely generous. They now amount to 70% of the net average national wage, but this is set to fall to 67%, using a new system of calculation, which will be the equivalent of only 64% under the old system. Workers will also be held to contributing for 45 years to draw their pension in full. The current average is 37 years.

The costs of the health-care system, into which workers and employees jointly pay another 14% of gross wages, are also spiral- ▶





Pensioners' paradise

ling out of control. The Social Democrats say they do not want a two-tier system, as in America, but accept that change will have to come. That may take the form of providing all workers with free basic health care but perhaps charging for amenities that have hitherto been taken for granted, such as generous supplies of medicine and instant access to specialists.

Unemployment benefit too is proving costly when so many people are out of a job. Benefits depend on age, length of previous service, family circumstances and so on, but at the top end of the scale a recipient with one child can get 67% of previous net income (up to a maximum of €1,875 a month) for as long as 32 months. At the bottom end, a young jobless person who has never had a job or who has worked for less than two years is not entitled to any unemployment benefit at all—but may be eligible for (less generous) means-tested welfare assistance.

The biggest need of all, though, is to reduce unemployment itself, currently stuck at 9.8% by the Germans' own seasonally adjusted measure (or 8.3% according to EU statistics). That means at least 4.1m workers without jobs. The most vital need is to free up the labour market, in particular by making hiring and firing easier and by letting labour become cheaper. In some respects, Mr Schröder's government has actually made matters worse in the past four years. For instance, it abolished the special status of low-paid workers in "DM630 jobs" (now known as €325 jobs in the new currency), after the top limit on monthly earnings under this rule. Until then, employers had to pay only a modest flat-rate tax on such jobs, and employees nothing at all. They still escape, but employers now have to pay 22% in social-welfare contribu-

tions. The government also lowered the number of employees above which a company is obliged to have a works council and give workers time off for its business.

There had been hopes that Mr Schröder would continue with the liberalisation of Germany's restrictive shopping hours embarked on in 1996, but opposition from trade unions, as well as churches, proved too strong. Since the reform six years ago shops have been able to stay open until 8pm on weekdays and 4pm on Saturdays, but still not on Sundays, with only a few exceptions. If the rules were relaxed further, the sector could offer many more job opportunities (although small shopkeepers are strongly opposed to more liberal opening hours).

The main hope for at least starting to reform Germany's labour-cum-welfare system rests with the proposals to improve

the labour market made by Peter Hartz, a top vw manager. When these were published in August, Mr Schröder instantly promised to implement them in full. If so, Mr Hartz claimed, his measures would create 2m jobs within three years. That may be too sanguine, but they would certainly make a difference.

### Take Hartz

Mr Hartz's aim was not to change the labour market from the ground up—that, he said, was not his brief—but to make job placement more efficient, as well as to encourage temporary and short-term work, which Germany's highly regulated system currently discourages. The trade unions, which in the past have been fierce defenders of the status quo, have broadly endorsed the Hartz proposals "in principle".

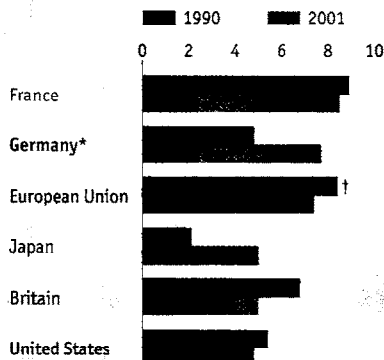
The most controversial proposal is the creation of "personnel service agencies", to be run mostly by private temp agencies, which will take on people who have previously been unemployed and hire them out as temporary workers. Those who reject an offer of employment from such an agency will risk having their benefits docked.

Mr Hartz also tries to tackle the bottom end of the labour market to counter widespread tax evasion and create more legal jobs. One of his suggestions is for "mini-jobs" with private households, where people earning up to €500 a month will pay no tax or social-security contributions and the employers will make a flat-rate contribution of only 10%, an improvement on the old "DM630 jobs". Another is to give self-employed people tax incentives to set up companies (with a minimum of paperwork) known as "Me plc", which allow them to earn up to €25,000 taxed at a nominal rate of 10%, at the same time as collecting a state allowance that will gradually taper off over three years. Mr Hartz also wants to trim benefits for single people who refuse to accept a job simply because it would mean moving house.

In general, his proposals put more of an onus on the job-seeker to explain why a job is unsuitable before the state will provide him with welfare. All this will require a big change in expectations. The Hartz proposals would be an excellent first step towards labour-market reform, but some powerful trade unionists are beginning to grumble about the bolder of them. Depressingly, in recent weeks Mr Schröder has started to back away from his promise to adopt the lot, and started to water some of them down. ■

### Doleful

Unemployment rate, % of labour force standardised definition



\*1990 western only; 2001 western 7.5%, eastern 17.5%, national definition †EU12

Sources: OECD; Federal Statistics Office



# Is the sun rising in the east at last?

The mood in the "new states" is beginning to brighten

THE figures still look dismal. More than a fifth of the east German labour force is out of work, if you include those on the government's short-term job-creation schemes. Average wages are still only 77% of west German levels. Life in much of the "new Länder", as the former communist east is known, remains glum. The brightest and best of eastern youngsters still tend to head west. The downturn in the world economy has battered many new eastern companies. More recently, even nature has been hostile: the floods along the Elbe river in August wrought damage now put at €9.2 billion, most of it in Saxony.

Even so, prospects in the east are, on balance, distinctly more hopeful than they were. Some parts of the region have started to exude a new sense of purpose, confidence and creativity. Manufacturing output has shot up. Clusters of automotive, electronic and high-tech industry are beginning to form, especially in Thuringia and Saxony, which were hubs of German industry before the second world war.

Bernhard Vogel, the Christian Democratic premier of Thuringia, says that it no longer makes sense to talk about eastern as opposed to western states. He points out that his capital, Erfurt, is actually further west than Munich, its Bavarian counterpart. Saxons and Thuringians are beginning to promote themselves as "Middle Germans"—as distinct from their poorer compatriots from Mecklenburg-West Pomerania and Brandenburg, the *Land* that surrounds Berlin.

Yet despite the vast dollops of cash and subsidies that have flown east, progress is slow. Since the end in 1995 of the construction-driven boom that followed unification, the area's economy has grown at about half the (already snail-like) pace of Germany's western states. Last year the eastern economy shrank, and this year it probably stood still.

Yet huge amounts of money continue to flow east. By the end of this year the tally of net transfers since unification will have reached about €800 billion, nearly twice this year's budget for the whole of Germany. Last year the east received net transfers of €75 billion. And Mr Schröder has agreed to a final "solidarity package",

mainly to boost infrastructure investment, that will be dispensed from 2005 until 2019, worth a total of €156 billion. All this is courtesy of German taxpayers, eastern as well as western, though the westerners, being richer and much more numerous, are stumping up the vast majority of it.

## Buds of hope

It would be an exaggeration to say that the east now presents the "blooming landscapes" which Helmut Kohl, the chancellor at the time of unification, unwisely predicted in the first rush of euphoria; but progress has been immense. By virtually every material yardstick, life has improved. Rivers and air are incomparably cleaner. More than 800,000 new houses have been built since 1993, and the old central squares of just about every eastern town have been fastidiously restored. The

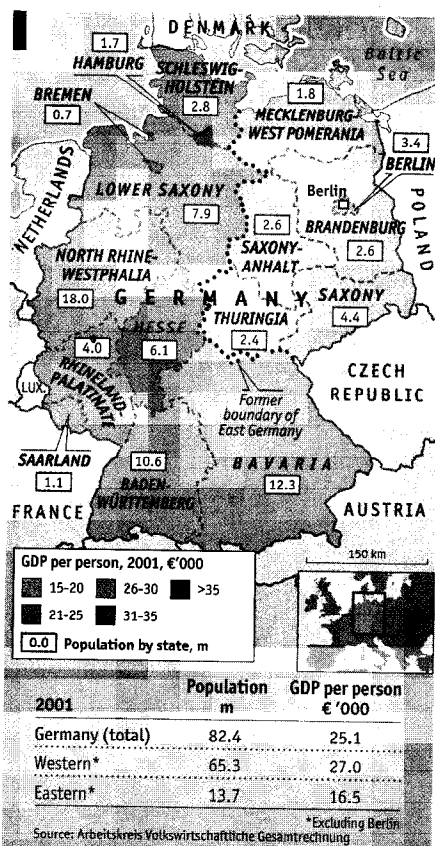
new telephone system is as good as any in Europe. New motorways link up every corner of the region. Even the poorest and most isolated little towns have shops stocked with a range of foods that would have been unimaginable in communist times. Car ownership has nearly trebled since 1989, and the wheezing old Trabant, old East Germany's family car for which eager buyers had to wait an average of nine years, is now a museum-piece.

Wages have nearly doubled in real terms since unification, GDP per head is up by 62% and pensions have soared—but there has been little or no growth in any of these since 1997. Labour productivity, by some calculations, has risen from 57% of western Germany's figure to 78% today, and in some manufacturing sectors it is as high or higher. Since 1990, more than three-quarters of industrial plant has been replaced. Even the retired and jobless, distressing as their plight remains, are financially better off than in communist times.

For sure, many Ossis (easterners), especially older ones, have yet to recover from the trauma of unification; some never will. After all, in its immediate aftermath, 7.5m of the east's 10m workers lost their jobs as whole industries were shut down. The number of industrial workers has plummeted from 7m to 700,000. The size of the labour force has shrunk by a third. And the 16.4m people who were living in the east in 1989 have come down by 1.8m, many of whom are reckoned to have moved over to the western side.

All this still haunts many easterners. They do not enjoy being told that 8,000 people now produce the same amount of steel in the east as 86,000 did a decade ago, or that the 40,000 Saxons still working on the land now grow more farm produce than 200,000 did in 1990. Nearly all public-sector workers in the east, doing exactly the same work as their western compatriots, still get, on average, only 90% of the western rate—and have to work 90 minutes longer per week for it.

Even in firms such as VW, where thousands of Ossis would be delighted to get a job, rates of pay and conditions in east German plants differ sharply from those in the west. At VW's biggest German plant, in



► Wolfsburg, not far from the western city of Hanover, the average working week is now 31.5 hours. Many of the workers have a four-day week. In Dresden, in Saxony, the average is 38 hours, and a six-day week is quite common. Yet pay rates in the east are considerably lower. Five-sixths of eastern industrial firms, covering one-third of industrial workers there, have opted out of collective wage-bargaining. The Saxon minister for the economy, Martin Gillo, says that, because average productivity in the east is still well below western levels, even with its lower labour costs the east is still not fully competitive.

### Saxon angles

It is bad luck on the northern half of the old German Democratic Republic that the best economic prospects are concentrated further south, on a 220km-long corridor running more or less along the A4 motorway from Erfurt to Leipzig and on via Zwickau and Chemnitz through to Dresden. This is where, under the so-called

*Leuchtturmpolitik* (lighthouse policy), business and government promote investment in beacons of industry and research that might bolster the local *Mittelstand*.

It seems to be working, thanks partly to large federal subsidies for investment. The Saxons boast that theirs is the only state in Germany where three car makers have chosen to invest in new plants: BMW and Porsche near Leipzig, VW in Mosel, near Zwickau, and in Dresden. All three firms say they are happy with the results. All insist that the quality of their workers is as good as in their western plants.

In Dresden, it is hoped that a high-tech cluster will form around two firms that specialise in semiconductors: Infineon, a spin-off from Siemens, and AMD, an American outfit headquartered in California's Silicon Valley. The pair have recently set up a high-tech joint venture with another American firm, Du Pont. Mr Gillo used to run AMD in Dresden until he became Saxony's economics minister earlier this year. He was born in Leipzig but has

spent a good chunk of his working life in Silicon Valley, and he is bubbling with eagerness to see Dresden take off as a high-tech centre. Some 500 small software companies, he says, have sprung up in the area in the past few years.

Dresden is a marvellous mixture of old and new. The old city centre is an architectural jewel. According to its liberal mayor, the city is already Germany's sixth most popular tourist destination. In 2005 the exquisite Frauenkirche, flattened by Allied bombers in February 1945 in a raid that killed 25,000, will reopen after a meticulous resurrection, virtually stone by stone: a fitting symbol of Dresden's rebirth after six decades of totalitarian blight.

A notable change over the past few years has been the growth of a fierce new sense of local pride. Kurt Biedenkopf, the Christian Democrat who was Saxony's premier for the first decade after unification, says regaining that pride is the Saxon people's greatest achievement. But elsewhere in the east, too, the sense of having ►

## Borderline cases

DRIVE two hours south-east of Dresden, close to the forested frontier with the Czech Republic, and you come to a sad little frontier town called Grossschönau. This is where Konrad Havlat, 47, prototype of the dogged, courageous entrepreneur who remained self-employed under communism, has turned himself from a humble leather-cutter into an independent businessman whose firm turns over €4m a year and employs 64 people. He now churns out a bewildering variety of steel parts. Next year he intends to open a plant with 130 workers in the nearby town of Zittau.

But life for his kind of small businessman is hard and risky. On occasion, he admits, the banks have had to be kind to him. New firms like his are highly vulnerable to Germany's economic ups and downs. Just like his counterparts in western Germany, he complains bitterly about the inflexibility of the labour laws. He notes that social-security costs are much lower just across the border, in Poland and the Czech Republic.

Labour flexibility is essential to his

success, he says, particularly being able to get his employees to work longer hours to fulfil urgent orders. He seems acutely aware that they could earn twice as much if they found similar jobs in, say, Stuttgart. At least a quarter of the people of Grossschönau, which once supplied the Saxon royal family with towels, have taken off since unification, mostly to seek jobs in the west.

An hour's drive north along the Czech and then the Polish border (which both seem pretty porous) takes you to Görlitz, on the west bank of the River Neisse that marks the post-war boundary with Poland. This is one of the most beautiful small towns in Germany, with many superbly restored buildings and squares. But the mood is sad. The place has too few Havlats, perhaps. Even more than Grossschönau, it seems empty of children and young people. The go-ahead seem to have taken flight, and tourism alone cannot sustain the place.

But business may perk up when Poland joins the European Union in little more than a year's time. Many Poles al-

### Saxon snapshots

ready cross the river from their decrepit side of the town, Zgorzelec, as they call it. Some Germans, for their part, have leased land on the Polish side, and people from Görlitz drive over for cheaper petrol and cigarettes.

Drive another 50km to the north-west, and you are faced with the bleakest of these three Saxon snapshots. Hoyerswerda must be one of Germany's ugliest towns. At the end of the second world war, it had just 6,000 people. After the war, the communists decided to exploit a huge coalmine underneath it, swelling the population to 70,000—housed in block after block of hideous high-rise concrete hulks, utterly devoid of a sense of community.

Back in 1991, the town gained a grim national notoriety for nastiness when a gang of racist thugs besieged an immigrants' hostel. Since then, a third of the people have gone. The young are still going. Of those left behind, a quarter have no job, or much prospect of finding one. Plainly, parts of the east are still slowly dying on their feet.



Serene again, the Elbe at Dresden

► been taken over and done down by the west is fading.

After unification, almost the entire old establishment of the German Democratic Republic was swept away. Nearly all managers in industry and most university professors were chucked out, as were any public-sector workers with links to the Stasi, East Germany's secret police. Easterners, it was felt, were on the scrapheap.

#### Ossis rule OK

No longer. Five years after Mr Biedenkopf, once the Christian Democrats' general secretary, took over the running of Saxony (a post to which he was twice handsomely re-elected), his entire government was still made up of westerners, bar one Ossi. Now the only Wessis in the Saxon government are his successor as premier, Georg Milbradt, and his economics minister, Mr Gillo—who left the east as a child.

Eastern politics are beginning to reflect that new confidence. In the early 1990s Christian Democrats had swept the board in the east, thanks largely to Mr Kohl's status as Germany's great unifier. They still run Saxony and Thuringia and now also,

in coalition, Saxony-Anhalt. However, within a few years many easterners were voting for the comforting certainties promised by the Democratic Socialists, a repackaged version of the old communists. Strikingly, in September's general election the ex-communist vote dived, because easterners now feel less need for a home-based party to bolster their identity.

In turn, Wessis, especially younger ones, are finding it easier to get along with Ossis. The cultural and social gap that was so apparent ten years ago is narrowing. The most striking sign of this is the surge of young Wessis at eastern universities, where more than a quarter of students now hail from the west. To be sure, there are practical reasons: the cost of living is lower, eastern universities are easier to get into, the staff-to-student ratio is more favourable, and academic standards remain fairly high. But social reasons play a part too. "My son used to think Ossis were really weird," says a western editor whose son has gone to university in Saxony. "But now he says they're more interesting." Not that social divisions have suddenly gone. A writer in Hamburg says most middle-

class Wessi parents would still sigh if their son introduced his bride-to-be as "Nina from [eastern] Magdeburg".

The other remarkable thing about the east is the way nearly all the region's businessmen and politicians complain about the burden of regulation, inflexible labour laws, high wages and social costs—just like their colleagues in the west. "The new states just aren't strong enough to bear the financial and regulatory burdens of the west," says Mr Biedenkopf, who can take much credit for luring western and especially high-tech business to Saxony.

Eastern leaders argue for more exemptions from onerous rules. But many Ossi workers, still egalitarian by instinct, fear that looser rules for business in the east might cause workers to be exploited. "We are all Germans now," is a common cry. That was why it was agreed in principle that wages and social benefits, although slightly lower in the east to begin with, should gradually converge. Mr Schröder has recently confirmed that within a few years public-sector wages must catch up. Alas, the sooner they do, the worse for Ossi job-seekers. ■

## Testing, testing

Germany is flexing its muscles abroad, but does not yet know how to use them

IT WOULD make a neat paradox to be able to say that as Germany's economy is weakening, the country is becoming more powerful in world affairs—thereby inverting the conventional wisdom that Germany since the second world war has been an economic giant but a political pygmy. But it would not be quite true. Germany's economy, as we have seen, is not what it was: the gap with France's and Britain's has been getting narrower. And the country is certainly shedding the guilty inhibitions that for half a century have dissuaded it from asserting its national interests. Yet it seems that Germany is not sure

what those interests are or should be.

Part of the explanation may be the giddy pace of recent change. During the eight years after unification in 1990, when Mr Kohl was in power, things had begun to move fast. Mr Kohl thought he knew what was good for Germany: "A European Germany, not a German Europe." Germany had to remain anchored firmly in the steadying waters of Europe.

But in the past four years under Mr Schröder, the pace has accelerated even further. The shift of the capital from quiet Bonn to history-heavy Berlin, a window on the Slav world to the east, has been a

potent symbol. Mr Schröder feels a lot less weighed down by his country's past, and wants Germany to pursue its own course, albeit in concert with other vessels. But he has also found himself on occasions unsure how or where to navigate.

Perhaps the most striking recent example of this new-found independence was the opportunistic way he milked the anti-war mood in his country for electoral advantage. His disparaging comments about President George Bush and his "adventurism" in contemplating a war with Iraq were offensive enough to the Americans, but the diplomatic damage was com- ►►

pounded when his then justice minister, Herta and Paul Amirian, apparently accused Mr Bush of plotting war to divert attention from problems at home, likening his tactics to Hitler's.

The American administration had not expected Mr Schröder to give it enthusiastic backing for its policy towards Iraq, but American diplomats say that Mr Schröder twice assured Mr Bush that he would not make a fuss about it. So the president, they say, felt betrayed as well as insulted.

### Class of '68

In any event, Mr Schröder's *démarche* may point up a deeper change in German thinking about foreign affairs. His government is full of "68ers", who were waving, or even using, their fists in the street protests in 1968, or who were sympathetic to the cause. Mr Schröder himself was head of the Social Democrats' youth wing when it still described itself as Marxist, and acted as a defence lawyer to a member of the terrorist Red Army Faction.

Among many 68ers, a visceral anti-Americanism persists. For this generation of Germans, as one writer puts it, "the two landmarks were Auschwitz and Vietnam." Part of their revolt was against their parents' generation, for their failure to stand up to Hitler, for the complicity of many of them in his crimes, and for their silence after the war. But another part of it was against America's military might—and its readiness to use force if need be—in the cold war. Such distaste for American power, still lingering among Greens and in some quarters of the Social Democratic Party, makes them promote the new Europe as a counterweight to the United States and NATO.

But none of this should be exaggerated. Many 68ers, including Mr Schröder and his foreign minister, Mr Fischer (who did use his fists against policemen in 1973), have genuinely changed their spots. Mr Fischer has said he owes more to Bob Dylan than to Karl Marx. More seriously, in recent times, he has often insisted on the importance of keeping the Americans engaged, with NATO, in Europe. Indeed, he deserves particular credit for persuading many of his old comrades that American power, at least usually, is benevolent. Likewise, Otto Schily, the interior minister (another 68er, who co-founded the Greens before switching to the Social Democrats), has demonstrated plenty of transatlantic goodwill by forcing through rigorous new anti-terrorist laws in the past year.

Though the Americans will not quickly

forgive Mr Schröder for his seeming disloyalty, it is in nobody's interest to let relations stay sour, so the chances are that they will gradually sweeten over the next year or so, especially if American policy towards Iraq produces good results. The United States still has about 88,500 soldiers and airmen deployed in two main bases in Germany. If the servicemen or the bases were needed during hostilities with Iraq, it would be surprising if Mr Schröder did not let the Americans use them. The cornerstone of Germany's security is still NATO, though it may get harder to keep it in sound order.

A much more profound change has been the virtual breakdown of the Franco-German political alliance, the most important on the continent since the second world war. For sure, even in Mr Kohl's latter days the relationship was sometimes tense. But over the past decade circumstances have changed so utterly that the famous Franco-German "engine of Europe" will never be the same again, despite efforts in the past month or two to revive it. With Germany now so much larger, and the prospect that ten more countries will join the European club in the next year or so, France can no longer lead a diffident Germany to suit its own purposes.

The EU's eastbound enlargement, a project scarcely loved by France, is continuing the shift in Germany's, and Europe's, centre of gravity that started with the widening of NATO to take in Poland, the Czech Republic and Hungary. A further expansion of NATO, to include Balts, Slovaks, Slovenians and others, will alter Europe's shape still more. And even though Mr Schröder recently gave in—

again, with astonishing opportunism—to the pleas of France's president, Jacques Chirac, that French farmers should continue to receive fat handouts, the day will come when farm subsidies will start to dry up. In sum, Europe is not going France's way, and Germany does not pretend that the Union is essentially a Franco-German enterprise any more.

But what, in German eyes, is it becoming instead? A few years ago, Mr Schröder was wooing Britain. Both countries' governments were touting a "third" or "middle" way. Britain's prime minister, Tony Blair, extolled the EU as a laboratory for free-market enterprise and liberalisation while also sounding politely sympathetic to Germany's wish for Europeans gradually to integrate. A year or so later, German-British friendship is not quite so intense. So long as Britain both stays outside the euro currency zone and fails to sign up fully to the Schengen pact that allows people borderless passage in most of western Europe, the Germans will never achieve the sort of intimacy with their neighbour across the Channel that they once enjoyed with France. So Mr Schröder's Germany is more independent—and less closely tied to old or new friends.

### Made in Germany

What sort of Europe does Mr Schröder want for Germany? His most immediate worry is the stability and growth pact to which the 12 countries that have jointly adopted a common European currency are pledged. Ironically, it was the Germans who were chiefly responsible for creating the pact, to ensure that profligate euro aspirants, such as Italy, would be unable to run ▶



Schröder and Chirac try to mend fences

## Who's a German, then?

IT IS an oddity of modern Germany that, even though the country has been friendlier than any other in Europe to asylum-seekers and refugees, foreigners settling there have found it extraordinarily hard to become German. There are 7.3m residents who do not have German citizenship, nearly 9% of the population. Some demographers argue that Germany will need 260,000 immigrants a year for the next 20 years just to keep its present population stable and avoid a financial crisis in its welfare and pension systems. Yet few indigenous Germans accept the notion that Germany is, or should be, a multicultural country.

Mr Schröder, to his credit, has started to change this by updating the rules on naturalisation, which were based on an imperial law of 1913 that defined Germanness mainly by blood. This meant that descendants of Germans who had settled in Russia under Catherine the Great could become German again at the stroke of a pen without knowing a word of German. Since the Soviet Union broke up, more than 3m have done so.

For the 2.5m German residents of Turkish origin (of whom about 500,000 may now have got citizenship), many of them second- or even third-generation, it has been much harder to get German passports. But now, thanks to Mr Schröder's change in the law, children of foreigners born in Germany, provided at least one parent has lived there for a minimum of eight years, are automatically given German citizenship at birth—though they have to choose whether to keep it when they come of age.

Earlier this year, Mr Schröder passed a law which marked Germany's first serious effort to match immigration with Germany's economic needs, with provision for a points system to lure skilled workers from abroad. The law, due to come into force next year unless the Constitutional Court blocks it, builds on a controversial scheme endorsed by Mr Schröder two years ago to give permits to up to 20,000 computer specialists from India and Central Europe to work in Germany on five-year contracts. The new bill also makes it easier for foreign students educated at universities in Germany to stay on, and easier for self-employed foreigners to work in Germany.

Many politicians, mostly on the right, have opposed the changes. Two years ago Jürgen Rüttgers, the Christian Democrats' leader in North Rhine-Westphalia, Germany's most populous *Land*, demanded "*Kinder statt Inder* (children, not Indians)", meaning that Germans should have more babies instead of relying on workers from abroad. Mr Stoiber backed

idea, albeit in more cautious terms, and so have other politicians of all stripes.

Europe, they insist, needs a stronger parliament of its own and an elected president of the commission. But they have no objection to a stronger Council of Ministers, as France and Britain want. Indeed, Mr Schröder has suggested turning the council into an upper chamber of the European parliament, along the lines of Germany's own Bundesrat where the 16 *Länder* are represented. Compared with the French and British, the Germans remain fervent advocates of ever closer integration. They see the euro as paving the way for a tighter political union.

What about "enhanced co-operation", the old jargon for a core group within the EU to keep things moving forward if scep-

Multiculturalism still jangles national nerves



Side by side doesn't mean together

him, suggesting that the current rate of child benefit should be tripled. Friedrich Merz, the Christian Democrats' then leader in the Bundestag, said immigrants must accept that each country has its *Leitkultur*, or predominant culture, to which newcomers must adapt. That set alarm bells ringing in Germany.

By any standard, Germans of foreign origin—and particularly from Turkey, easily the biggest minority—are woefully under-represented in politics and public life. For example, only a couple of them sit in parliament, compared with 38 non-whites currently in Britain's two chambers. Being generous to asylum-seekers is one thing, but absorbing foreigners into the German family still revives old neuroses about national identity.

► large deficits. Now the pact's conditions are causing particular hardship for the German economy, which needs anything but fiscal tightening. The French, for their part, are getting round the problem by blithely ignoring the pact.

A much bigger conundrum for Germany, however, is to find a new way for an expanding European Union to function. For all Mr Schröder's talk of asserting national interests, he and most Germans in what they like to call "the political class" are still accustomed to promoting German interests through the filter of the EU. Mr Fischer, who has proved a highly creative foreign minister, set the tone in May 2000 when he outlined his vision for Europe: a federal government of European states. Since then Mr Schröder has echoed the

tics such as Britain and the Nordics prefer to stay aloof? The French sometimes toy with the idea of setting up a *directoire* of top countries to run the show. But the Germans know that this would cause outrage among small countries and newcomers.

Mr Schröder is not, in fact, very interested in dreaming up foreign-policy visions for Europe. But he does have a strong sense that Germany should seek "normality" in the world, on the understanding that, although the crimes of the Third Reich must not be forgotten, modern Germans should now have, in his words, "the self-confidence of a nation that has come of age, that feels neither superior nor inferior to others."

Hence his courageous decision that, if his country was going to be normal, it had ►►



► to be ready to send troops abroad, if necessary to kill or be killed. His most creditable foreign feat was to send German forces to Kosovo in 1999, to help keep the peace in Macedonia a year later, and then, a year ago, to persuade the many doubters on his own side that he was right to send troops to Afghanistan. With 10,000 men abroad, Germany is now second only to the United States in the number of its troops deployed on such missions around the world. Germany's long-time foreign minister under Mr Kohl, Hans-Dietrich Genscher, once said that no German soldier would ever be sent to a country that had been conquered by the Germans in the second world war. In the Balkans Mr Schröder bravely broke that taboo.

### Who will run the show?

The grandiose talk about the EU's new foreign policy continues to look silly whenever a real global crisis erupts, as it has done over Iraq. At such moments, the two countries in Europe that have kept a strong military tradition and serious fighting forces to go with it, France and Britain, invariably go their own way. These days that makes Germany feel all the more left out, particularly since the joint French-British declaration in St Malo in 1999 to create the embryo of a European defence policy together. "It is no good our pontificating from the sidelines," says Christoph Bertram, a defence expert in Berlin. "After St Malo it was clear we had to get on board."

Must they? Only up to a point. A readiness to send combat troops abroad (pro-

vided Germany is part of a collective effort) is new and, after early ructions on the left, has now ceased to be controversial. But, as American defence pundits put it, Germany has "no real teeth and a very long tail". Despite its army of 310,000 (including 118,000 conscripts), the largest in Western Europe, it has a feeble fighting capacity. Its defence budget, at 1.5% of GDP, is among the lowest in the EU—although the revised budget figures for next year, which provide for an overall cut in government spending of 1.8%, show a 3.2% increase in spending on defence.

National pride, let alone nationalism, is still a delicate subject in Germany, certainly among the older generation. Only last year, a Christian Democrat leader got into hot water for declaring that he was "proud to be German". Germany's president, Johannes Rau, a Social Democrat, was at pains to disagree: he was "glad" he was German, even "grateful" for being one, but he could not be proud of something he had not achieved himself. Mr Schröder said he was proud of what "people have achieved, and of our democratic culture". One ex-68er, now a successful journalist, explains that even cheering on his country at international football matches still makes him feel awkward.

In most German eyes, it is still unacceptable to be rude about Israel's government, or even about individual Jews, though Israel's current leader, Ariel Sharon, may be an exception. In any other European country, the outspokenness on the Middle East of the Free Democrats' Mr

Möllemann would not have caused a national row; nor would there have been outrage over a novel by Martin Walser, who had portrayed a fictional Jewish literary critic (bearing a striking resemblance to a real one in Germany) so unsympathetically that the broadsheet *Frankfurter Allgemeine Zeitung* refused to publish excerpts as previously agreed.

And yet, under the veil of building European unity, a new assertive prickliness sometimes shows up. The new Germans, less weighed down by guilt, are ready to express their frustration at the reluctance of countries such as Britain, France and Spain to pool their sovereignty. To those not in favour of much more European integration, German talk of its "inevitability" can sound rather menacing.

At the same time, Mr Schröder is much more forthright than Mr Kohl used to be in telling the European Commission in Brussels to get off Germany's back. He is particularly protective about the rights of the *Länder*—for instance, to subsidise their local banks and ailing industries, even if that flouts European competition rules. And he is much more prepared to voice German resentment of the disproportionate sums his country still pays into the EU kitty.

All this seems reassuringly normal. After all, it is what other EU members, such as France and Britain, have been doing all along. Mr Schröder has moved Germany a long way towards freeing itself from the inhibitions of the past. But it will be a great deal longer before the shadows of history stop haunting the country altogether. ■

## The trouble with contentment

When life is so pleasant, there is little incentive for radical change

IT WOULD be entirely misleading to paint Germany as a country that is shabby or miserable, prone to political instability or in danger of terminal economic decline. On the contrary, it remains rich, stable and, for the overwhelming majority of its people, very pleasant to live in. Growth may be slow, unemployment high and the *Mittelstand* gloomy, but on the whole the climate of society still strikes the outsider as fairly sunny. There is hardly any visible poverty of the kind found in the more depressing bits of Britain or France. Germany's high-tax regime and rigid labour markets may be damaging to

its economic prospects, but its welfare and health-care systems are generous and its infrastructure is superb.

Nor is the pleasantness of German life just about material living standards. Modern architecture, on the whole, is refreshingly enterprising. Many companies and institutions take pride in enlivening their physical surroundings, commissioning public works of art, such as sculptures and fountains, for all to enjoy. There is also a strong awareness of environmental issues, so recycling is taken to heart and bicycle paths and forest trails are abundant.

One of Germany's greatest attractions

is its regional variety, which goes a long way towards giving Germans a sense of local community and pride. Berlin may, since resuming its role as capital, have become *primus inter pares* in a way that Bonn could never have been, but half a dozen other cities can lay claim to excellence in their particular fields, and gather up some of the country's brightest and best. Hamburg still has the pick of the media, Frankfurt has the finance, Munich has an enviable mix of business, media and culture ("laptops and *Lederhosen*"). The Constitutional Court is in Karlsruhe; the headquarters of the country's vast labour office is in ►►

► Nuremberg; the biggest art market is in Cologne; the main trade union federation has only fairly recently moved from Düsseldorf to Berlin.

This decentralisation is good for politics. Most of Germany's top politicians (including Messrs Schröder, Stoiber and Kohl, among many others) first made their mark in one of the 16 *Länder*, which each has its own parliament and government. Each *Land's* ruling party (or parties, if there is a coalition) sends representatives to the Bundesrat, Germany's federal upper house, which can block about half of all legislation, particularly the financial sort. The *Länder* have no power to raise taxes, but merely distribute cash from budgets set at federal level. However, they control education, the police and prisons, and can affect business by touting for investment, lobbying in Berlin and Brussels, and helping to speed up planning permission and cut through red tape.

Germany's post-war decentralisation (as well as an electoral system based on proportional representation) was, in fact, decreed by the conquering Allies to ensure that power could never again be monopolised by one man at the top. But whatever its origins, it has suited the country very well—and helps to explain why, to a German, federalism means something much more positive than it does, say, to a Briton.

But decentralisation has drawbacks too. For one thing, because decisions are taken on several levels, rapid or drastic change is hard to achieve. It feeds a tradition of compromise and consensus to which most German politicians are firmly wedded. And it makes governments more reluctant to contemplate big changes when they are needed.

#### Don't wait too long

The question is, does Mr Schröder believe that fundamental changes are needed? Or does he hope that, as the world economy recovers and Germany's eastern states become more self-sustaining, things will gradually come right anyway? The answer is probably a bit of both. Mr Schröder is an intelligent man who listens to a lot of people, including many of Germany's big businessmen. Even since the election he has acknowledged that his government must trim welfare and health-care costs and do something to lighten the pensions burden. But he himself, brought up in poverty by his mother, who worked as a charwoman to keep them going (his father having been killed in the war), is a product of a system that he admires; after all, it served



If only they could be bold about everything

Germany handsomely in the years of reconstruction, and made it the rich and steady country it still remains.

Much depends on what happens in the next four years. It is conceivable that if the economic situation gets much worse, the chancellor might steel himself for a break with the consensual past, even at the risk of labour strife. Some say that only a government of the centre-left has a chance of persuading the unions to accept an end to the job-destroying status quo. Others argue that the only way to save Germany from permanent stagnation is a "grand coalition" of the two main parties, which could muster an enormous majority to force through unpopular decisions. But a period of grand coalition in the 1960s is still remembered for producing more problems than solutions.

Commentators, especially from abroad, have been predicting gloom and doom for Germany's economy for a decade or two. It still hasn't arrived. But growth has clearly slowed down dramatically, and governments at the federal, regional and local level have started running out of cash. So far, for the large majority of Germans in work and even for the 4m without it, the slow decline is unlikely to mean empty wallets, let alone empty stomachs. This is not like the 1920s and 1930s, when the jobless were truly desperate and therefore easily drawn into the web of totalitarian politics. But someone—perhaps the chancellor after Mr Schröder, or the one after that—needs to start making radical changes. Otherwise, a few years hence, life in Germany really will become a lot less pleasant. ■

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